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CORPORATE CREDIT UNION

April 1, 2009

The Honorable Michael E. Fryzel
Chairman, National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Rodney E. Hood
Vice Chairman, National Credit Union Administration

The Honorable Gigi Hyland
Board Member, National Credit Union Administration

Re: Comments on Advance Notice of Proposed Rulemaking for Part 704

Dear Chairman Fryzel, Vice Chairman Hood, and Board Member Hyland:

Kansas Corporate Credit Union (Kansas Corporate) appreciates the opportunity to provide perspective and comment on NCUA's Advanced Notice of Proposed Rulemaking (ANPR) and Request for Comment regarding the role of the Corporate Credit Union Network and its structure.

The economic events over the past couple of years have created a global market crisis that has impacted all financial institutions in one form or another, including corporate credit unions. We are all immersed in what's being called the "Great Recession" and we are reminded of these difficult times on what seems like a daily basis as companies across the United States announce layoffs and losses. The financial institution problems have been exacerbated by accounting rules that create large "accounting" losses, while the actual real "dollar" loss may be much less than stated. We have seen events over the past year that none of us thought we'd ever see in our lifetime. Bear Stearns, Lehman Brothers and Merrill Lynch all gone. Washington Mutual and Countrywide are now both gone and Fannie Mae and Freddie Mac have been taken over by the government to restore confidence. Enormous stimulus packages have been passed and implemented in an effort to stimulate and turn the current economy around.

Truth is that most of the events that lead to the Corporate Stabilization Plan were put into play by very well intentioned folks that couldn't imagine that things could or would get this bad in our economy. For years, credit unions have appreciated the higher yields on investments and lower prices on services that they were getting from their corporate credit union. Corporate investment managers were sticking to the highest rated securities, those rated by agencies using valuation models that got them through many recessions, until this one. We agree that it's appropriate to review the role of the Corporate Credit Union Network in light of the recent actions taken, but we remain concerned that the review is coming at a time when uncertainty reigns in the financial markets, and decisions made in haste could in the long run be to the detriment of the credit union system or individual credit unions.

8615 West Frazier Wichita, Kansas 67212 1.800.721.CORP Toll Free 316.721.2600 Phone 316.722.2025 Fax www.kansascorporate.org

Background/Figures regarding Kansas Corporate Credit Union

Before we comment directly on the questions asked in the ANPR, we want to provide you with background and facts and figures regarding Kansas Corporate and the critical role that we play with our 130 members. Kansas Corporate allows our members to reduce their reliance on their competitors for financial services; allows them to take advantage of economies of scale to receive financial services at a lower cost than if they went to a vendor directly; and by providing much of the back office functions that allow our member credit unions to operate more efficiently at a lower cost and letting them focus on servicing their individual members.

Kansas Corporate has been in existence for 58 years, as we were chartered in 1951 as the first corporate credit union that served only credit unions. We were chartered by visionary individuals to provide Kansas credit unions with access to liquidity at reasonable rates. By creating Kansas Corporate, credit unions in the state could indirectly serve the borrowing needs of all Kansas credit unions by providing a vehicle to move funds within the industry to credit unions with high loan demands. This role as a liquidity provider is still our main purpose today. However, over the years, Kansas Corporate has added other financial services at the request of our membership and now provides the majority of financial services that our members need to eliminate any reliance for those services from one of their competitors.

Today, Kansas Corporate provides liquidity services with over 105 members having pre-approved lines amounting to $199.3 million, and Kansas Corporate advanced over $1.7 billion in loans during 2008 to meet the liquidity needs of our membership. Of the 15 Kansas credit unions with borrowings as of December 2008, 14 had outstanding borrowings from Kansas Corporate.

A role that increased over the years is providing investment services for members with excess liquidity. We offer a wide range of investment products and also offer off-balance sheet investments such as SimpliCD through our ownership of Primary Financial to simplify the process of investing in CDs, and marketable securities through our relationship with CU Investments Solutions, Inc. Our board of directors view Kansas Corporate's market share as any investment that we facilitate, whether on-balance sheet or off-balance sheet. As of December 2008, Kansas Corporate's market share of investable funds was 51.6% with 23.0% invested in Kansas Corporate and 28.6% facilitated by Kansas Corporate in off-balance sheet investments. According to the latest figures, the average yield on investments for all credit unions in 2008 was 3.93% versus the average of 3.97% for Kansas credit unions. This additional 0.04% yield on an average investment balance of $688.7 million for 2008 translates to $275,465 in additional investment income for Kansas credit unions. We believe some of this additional income can be attributed directly to Kansas Corporate based upon the fact that we helped to facilitate the placement of 51.6% of the outstanding investments.

Kansas Corporate correspondent financial services allow us to act as a facilitator as we provide the services to many credit unions, which allow us to take advantage of the economies of scale to negotiate better pricing with vendors. This in turn, allows our members to provide those same services to their individual members at a lower cost and more efficiently from another vendor. Additionally, since we don't provide our services to the general public, our operating overhead is low and therefore we can price our services at reasonable levels and eliminate their need to have funds in non-earning accounts at a competing financial institution.

Kansas Corporate serves as the wire correspondent for 113 members and on a daily basis we average 48 incoming wires for $19.8 million and 71 outgoing wires for $6.9 million. We serve as the ACH correspondent for 85 members and on a daily basis average $7.3 million in debits and $10.5 million in credits. Members that use our APEX-ACH product received over 4.5 million ACH items and originated over 200,000 ACH items during 2008. We serve as the correspondent for 82 members for the settlement of their check deposits and check clearings and on a daily basis members average $16.8 million in deposits and $14.6 million in clearings. Kansas Corporate's currency delivery and vaulting service which is a partnership with two local armored carriers was developed at the request of our membership in 1999 in preparation for Y2K and now serves over 90 locations throughout the state and more than $500 million in cash was ordered and delivered during 2008.

Adding value and saving our members costs is represented in two additional services Kansas Corporate offers. Asset and Investment Management (AIM) is a fee-based service that was started in 1993 at the request of the membership when interest rates were low and loan demand weak. The service helps credit unions with their asset/liability management and ensures that credit union management and volunteers are making well informed decisions when pricing their loans, shares, services, or the impact on their bottom line of implementing a new service or a new facility. The service provides quarterly income simulation, rate shocks and net economic value analysis at a fraction of the cost to the credit union if they purchased the software, paid annual maintenance fees and had to hire staff to learn the software and dedicate the time necessary to use it effectively. Currently, 35 member credit unions use the service and they represent more than 40% of the assets of Kansas credit unions. Kansas Corporate's ownership in CU Business Group was the result of the work of a Small Business Task Force comprised of credit union CEO's that felt this vendor was the best choice to meet the business services needs of Kansas credit unions without having to spend the time and money to develop the expertise in-house.

We respectfully submit the following comments on issues under consideration in the ANPR.

The Role of Corporates in the Credit Union System

Kansas Corporate disagrees with the statement in this section that, "recent events have highlighted structural vulnerabilities in the corporate credit union system." We believe that same statement could be made about almost any industry in today's economic environment. We don't believe that structural vulnerabilities contributed at all to what caused NCUA to implement the Corporate Stabilization Program. We do believe that the events have highlighted issues within the current regulation with regards to expanded authorities and to the appropriateness of risk measurement and modeling requirements contained in the regulation in light of the severity of today's economic crisis in comparison to historical crises in which many modeling requirements have been based upon.

Payment Systems

Kansas Corporate and all corporate credit unions settle many types of transactions from numerous payment systems each and every day. In the case of Kansas Corporate, some include payments we faciliate (fund transfers, APEX-ACH) while other payments are facilitated by other entities (Federal Reserve Bank, league service corporations, third-party processors outside the credit union system, CUSOs, etc.) while we provide the settlement services.

We believe that separating payment systems services would almost certainly increase the cost associated with providing the services and therefore produce higher fees to credit unions reducing the value of the cooperative alternative. The majority of credit unions would prefer to use a cooperative provider for payment services and many of the current corporate payment systems provide aggregated cost savings and are less burdensome to the user.

There are some corporates today that offer an array of payment systems and they do it well because they have the operational discipline to acknowledge and manage the risks associated with providing those services. The risks associated with payment systems and investments are different and must be measured differently. We believe that a risk-based capital system would more directly address the types and degrees of operational and investment risks taken by an institution and ensure that they have sufficient capital to support the risks taken. This would be a better alternative than varying from standard industry practice and require payment systems to be isolated from other services.

Liquidity and Liquidity Management

We believe that providing liquidity to credit unions, managing liquidity to fund settlement activity, and aggregating member liquidity to earn a higher return on their behalf is a core service of Kansas Corporate and the Corporate Network. Liquidity concerns experienced over the past couple of years isn't isolated to the corporate credit union system, but rather has been an issue across all sectors of the financial industry. In fact, we believe that the corporate and credit union system has done an admirable job of ensuring liquidity has been available during this unprecedented economic downturn despite not having access to TARP funds, or for many, access to the Federal Reserve discount window.

We believe that it would be impossible and inappropriate for the regulator to try and specify by regulation the types of products and services that a corporate should be limited to offering in order to preserve liquidity. Corporates have liquidity measurements and processes in place today that have historically worked well and generally met the needs of credit unions. To the extent that those processes in individual corporates are inadequate to properly assess their cash flows and liquidity risks, regulators can and should require improvement under best practices and other guidance during the examination process. Kansas Corporate does not believe that cash flow duration should be incorporated within regulations. While duration should be considered as part of a corporate credit union's liquidity process, mandating it would restrict a corporate from adapting to a potential need of its members. We would suggest that a proper risk based capital system could also provide a sufficient measurement for regulators to determine if additional liquidity risks are being taken and properly managed by corporates.

The Central Liquidity Facility (CLF) has been a valuable, under-utilized tool for NCUA during recent months and Kansas Corporate would encourage NCUA to take all necessary action to assure that the CLF can take full advantage of its statutory authorities in providing funding to corporates in the future.

Field of Membership Issues

While it's true that the corporates are referred to as a "network" or "system", we are each democratically controlled, individual financial institutions. Every corporate has their own individual business plan based upon the direction of their board and membership.

Nearly all corporates have a national field of membership and the overwhelming majority of corporate credit unions are operating in a very safe and sound manner. Kansas Corporate does not believe that reverting back to a regional field of membership is necessary and certainly wouldn't reduce risk or improve a corporate's financial prospects. Limitation on membership certainly hasn't prevented the Federal Home Loan Bank system from experiencing similar issues and consequences that face the Corporate Network in today's economic environment. Credit unions are attracted to different corporate credit unions for a variety of reasons and we believe it's important to allow credit unions to exercise their choice in the selection of correspondent and investment services in a free-market environment.

The current issues facing the Corporate Network have not been caused by the field of membership or structure of the Corporate Network, but by market forces in the overall financial industry, and by the investment risks assumed by some individual corporates. Kansas Corporate has always had a national field of membership, prior to the majority of the Corporate Network having the same, but it's been our philosophy and business model to only serve credit unions that we can easily build relationships with, and that comes from being able to sit down face to face with members to gain knowledge of their needs and goals and how we might be able to help them achieve those goals.

Each corporate should be allowed to establish different levels of membership through its bylaws. This would allow credit unions to access services from the corporate that best suits its needs, and allows a corporate to limit particular services to a member by geography, capital investment or other membership requirements.

Expanded Investment Authority

The expanded investment authorities allowed under the current Regulation 704 have provided corporates with the choice of assuming additional risks in their portfolios if they have the appropriate infrastructure in place and have the ability to effectively monitor and manage the additional risks. Kansas Corporate has never felt that the benefits achieved from expanded investment authorities outweigh the associated costs, based upon our needs and the demands of our membership. We do not feel that the expanded authorities in and of themselves are an issue, but rather we question whether proper procedures and controls were in place at those institutions to effectively and safely exercise the expanded authorities. We also have to question whether NCUA has the appropriate expertise and processes to monitor, measure, evaluate, and control these activities as most corporates with expanded authorities have had full-time on-site examiners.

Kansas Corporate has no issue with continuing to operate at our current base level without direct expanded authorities, but we believe that all corporates should have the ability to do vanilla derivative transactions like interest rate swaps, caps and floors to manage interest rate risk only. Whether the ability to perform these transactions would be through attainment of expanded authorities directly, or through a wholesale corporate only, or through some centralized clearinghouse that would require approval of the transaction prior to execution.

Kansas Corporate encourages the adoption of risk based capital requirements and adherence to the Basel standards which would require additional capital as additional risks are assumed. We believe that corporate capital requirements should be on par with the rest of the financial industry. In the future, if corporates are held to the Basel capital standards than they should also have access to similar investment authorities.

Structure: Two-tiered System

The basic principal of the two-tier structure is to aggregate and centralize resources and expertise to take advantage of economies of scale, which is critically important given the narrow margins that corporates operate on in order to add value to our members. Kansas Corporate has chosen a business model that supports the two-tier system and would assume that most corporates that operate on a base or base plus authority level also rely on the two-tier structure. Clearly there is efficiency with the two-tiered structure as evidence by the similar rates and fees found at both corporates that rely on the two-tier structure, and those that have tried to recreate the structure internally.

Kansas Corporate believes that structure isn't and never has been the problem and the two-tier structure will always exist, whether it's U.S. Central or another vendor that the corporate has to use to replace U.S. Central. Is rebuilding the current structure a better alternative? We think not. If the two-tiered structure was eliminated, the process of converting to a radically altered structure could raise unanticipated operational risks, decrease current efficiencies and perhaps cause unforeseen disruptions in the $7 trillion in annual payment activity that currently is processed and funded through the two-tiered corporate system.

We do believe that the wholesale corporate will need to downsize in order to ensure that there is adequate capital to support its risk. We believe that the wholesale corporate may transition away from on-balance sheet term investment activities to focus more on operating in an investment advisory capacity and facilitating more off-balance sheet activities on behalf of the corporate system, facilitating external funding for liquidity to the network and serving as a centralized point and aggregator of payment-related functions. These activities could provide for greater stability at the wholesale level and a more efficient utilization of capital.

Corporate Capital

Kansas Corporate supports revising the capital standards at corporate credit unions to bring their capital requirements more in line with the standards applied by other federal regulators. Any revision of capital requirements should be undertaken in conjunction with the implementation of a risk-based capital system, so that every corporate won't be held to the same number, but rather the number or amount of capital needed to support the risks taken on the corporate's balance sheet.

Core Capital (Tier 1 Capital)

Core capital should consist of both retained earnings and paid-in capital (PIC) accounts. Retained earnings cannot be the sole capital resource for corporates. To raise a sufficient amount of core capital via retained earnings only would require corporates to increase their spreads on product offerings making them less competitive in the marketplace and forcing credit unions to accept lower earnings or look for other vendors. NCUA has clearly demonstrated PIC accounts are at risk and therefore a corporate's retained earnings, together with its PIC accounts should constitute core (Tier 1) capital.

Membership Capital Shares (Tier 2 Capital)

Existing membership capital shares are needed to supplement corporates core capital in order to fund additional products and services. To provide comparability with other financial institution regulatory frameworks, the NCUA should modify the requirements for membership capital so that the shares meet applicable Tier 2 capital definitions as imposed by other federal financial institutional regulatory authorities. Membership capital shares must be recognized as having value by financial rating agencies and by capital standards as outlined in Basel. Allowing membership shares to adjust with credit union balance sheets is necessary and it seems prudent to not allow for the return of funds if minimum capital ratios aren't met.

Risk-Based Capital and Contributed Capital Requirements

As stated earlier in several sections, Kansas Corporate favors implementing a risk-based capital system for corporates consistent with that currently required by other federal financial institution regulators.

As noted earlier in the Field of Membership section, Kansas Corporate does not favor mandatory capital contribution requirements; instead we believe this to be a choice for the corporate credit union through its bylaws. We would be in favor of giving corporate credit unions the option to condition particular services based on contributed capital and would allow flexibility in matching higher risk services to capital.

Permissible Investments

Kansas Corporate believes that corporates investment powers should be greater than that of the natural person credit unions in order for the corporates to add value to their members. If a risk-based capital system like Basel is enacted for the corporate system, then it would be important to align investment authority levels with other financial institutions under Basel standards for competitive parity. A risk-based capital system would also act as a self-regulatory force by matching appropriate investment risk levels to an institution's capital levels.

Kansas Corporate believes that it would be prudent to establish appropriate concentration limits for permissible investments in which principal and interest is not fully guaranteed. Any new investment product should not be permissible until an exhaustive review of the instruments characteristics has been undertaken, and a clear understanding of the risks has been quantified.

Credit Risk Management

Despite the dismal record of the major rating agencies and their role in the current market situation, they still represent the best opportunity to get an outside opinion on the quality of an investment. Kansas Corporate favors the use of at least two ratings, using the lowest rating to satisfy any minimum requirement. The use of more than one rating is beneficial as has been proven over the past couple of years, no one model or rating agency is perfectly predictive of the future and multiple ratings will provide broader views.

Most corporates have monitored their aggregate risk of credit spread widening as part of their additional testing required in their NEV modeling, however, today those credit stresses are 10 to 15 times wider than previous events, and the related modeling by corporates. Credit spread widening tests should be expanded to include stresses like those occurring in this most recent credit crisis.

NCUA, in meeting their supervisory role, might want to consider contracting with outside firms to periodically perform independent evaluations of credit risk across all corporates so that the same standards are used uniformly.

Asset Liability Management

The constraints of current NEV regulations properly result in an environment in which corporates hold a large percentage of their holdings in floating-rate investments and relatively short-term, fixed-rate securities. Credit spreads were not a leading cause of the current market dislocation but a symptom of the lack of confidence in the investment markets. As stated in the previous section, most corporates already test for credit spread widening as part of the supplemental NEV testing. However, the modeling should be expanded to include the unprecedented widening that has occurred during this current market dislocation, and this would not place an undue burden on corporates.

Kansas Corporate does not support reinstating net interest income modeling and introducing those variables that are inconsistent from one corporate to another. Additional modeling, including net interest income simulations, could be a required additional test for corporates with unmatched options exceeding current limits.

Corporate Governance

Kansas Corporate believes that the current governance structure of democratically elected representatives from among the membership is appropriate and consistent with the cooperative charter for retail corporates. Kansas Corporate does believe that natural person credit union representation on U.S. Central's board would provide important perspective. While the business model and lines of business of corporates are different from the consumer oriented loan model that natural person credit unions manage, having experienced and knowledgeable natural person credit union CEOs greatly benefits retail corporates and this could enhance the effectiveness of U.S. Central's role across the industry as well.

We support the ongoing education and training of board members and recommend that requirements in this area take into account existing training requirements for credit union management and officials. Kansas Corporate does not support term limits due to the time and expense to train directors, and the limited resources within our field of membership to fill our current volunteer positions. A better approach may be to limit length of time any individual board members may hold officer positions as this would ensure adequate change of leadership without losing experienced directors.

Kansas Corporate is strongly against the establishment of an outside director category. We believe the concept is counter to the fundamental nature of credit unions as member-owned and democratically controlled financial cooperatives. It would also increase operating expenses and present regulatory challenges in guarding against inappropriate relationships.

Other Comments

Kansas Corporate would like to offer one other comment not addressed in the ANPR. The NCUA has indicated that it is considering elimination of the Office of Corporate Credit Unions (OCCU). We believe that it's important that NCUA retain the OCCU or an equivalent function in order to properly supervise the corporate credit union system. The unique role, services and balance sheets of corporates necessitate specialized examination skills tailored to this industry.

Final Comments

Kansas Corporate is a critical component of the Kansas credit union movement and the corporate system is critical to all credit unions. Unfortunately, many in the movement today do not remember a time before corporates existed and the difficulties encountered in gaining access to liquidity and many of the financial products and services corporates provide today. While some in the credit union movement are upset with the corporate system due to the expenses they've incurred, it's important to remember the critical role that corporates play in processing and funding all of the daily settlement activity and providing lifeline financial services to help credit unions survive, compete and thrive in today's marketplace. Some do, as illustrated by Lee Williams, CEO of Central Star Credit Union in Wichita. In a recent article regarding the cost of the stabilization program Lee was quoted as follows: "Nobody likes to see a red number at the end of the year, but the corporate system is really worth us taking the hit." We believe that's the view of the majority of the 8,400 credit unions that consider corporate credit unions as their most valuable strategic business partner.

The structure of the corporate network did not cause the problems that required NCUA to take the actions they did in late January. In fact, we would argue that the market share that the corporate network has achieved not just in investments but in all products and services is due to the reach, and local knowledge of all corporates both big and small. The fact that corporates are local, have developed personal relationships and are responsive to local needs is why corporates have been as successful as they are.

The needs and wants of Kansas Corporate members is what determines our business plan. Our structure enables us the flexibility to respond to our members' needs and suggestions. Our members tell Kansas Corporate each and every day whether we are adding value to their operations by where they choose to invest their funds and conduct their financial business. The CEOs of each of our member credit unions live the credit union movement message of cooperative ownership in their own shops and understand their rights and responsibilities as member-owners. They value the relationship they have with us because we help them do a better job for their members. The most frequent comment I've heard from members regarding the ANPR process is that they want to make sure that whatever steps NCUA takes they don't want to be driven back to relying on their competitors and banking counterparts for services they currently receive from Kansas Corporate.

Kansas Corporate members have stepped up before in the early 80s by depositing funds earning significantly below market rates to help their corporate offset the impact of low-yielding long-term GNMA investments. We have no doubt that the membership will take whatever steps necessary to ensure that their corporate will continue to exist in the future under whatever changes are made to the regulations. While corporates often function cooperatively, we respectfully ask that the Board recognize that we are individual, member-owned financial cooperatives with primary fiduciary responsibilities to our individual member/owner credit unions. Therefore, any plan addressing corporates should respect the individuality of each corporate while focusing on appropriate regulatory requirements for all.

We appreciate the opportunity to provide our comments and to participate in this rulemaking process. We look forward to continued dialogue with NCUA and the credit union industry as regulations and rules are developed in the future.

Sincerely,

Larry Eisenhauer

Larry Eisenhauer, President/CEO
Kansas Corporate Credit Union